

# **City and County of Honolulu Sewer Fund**

**Financial Statements**

**June 30, 2003 and 2002**

**City and County of Honolulu**  
**Sewer Fund**  
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## Report of Independent Auditors

To the Chair and Members of the City Council  
City and County of Honolulu  
Honolulu, Hawaii

We have audited the accompanying statements of net assets of the Sewer Fund, City and County of Honolulu ("Sewer Fund"), as of June 30, 2003 and 2002, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Sewer Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Sewer Fund at June 30, 2003 and 2002, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*PricewaterhouseCoopers LLP*

Honolulu, Hawaii  
December 16, 2003

# **Sewer Fund City and County of Honolulu**

## **Management's Discussion and Analysis June 30, 2003**

As financial management of the City and County of Honolulu Wastewater Enterprise, we offer readers of these financial statements this narrative overview and analysis of the financial activities of the Wastewater Enterprise for the fiscal year ended June 30, 2003. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements as a whole.

### **Financial Highlights**

- 110.8 million gallons per day of wastewater were collected and treated, a decrease of 3.7% from fiscal year 2002 reflecting continuing installation of low flow plumbing fixtures and dry weather. The Wastewater Enterprise as of June 30, 2003 had approximately 160,000 customer accounts and served approximately 600,000 residents.
- Total assets were \$1,576 million and exceeded total liabilities by \$708 million as of June 30, 2003. Net assets (difference between assets and liabilities) decreased by \$71 million or 9% from the prior fiscal year. The decrease in net assets is primarily due to transfers out.
- Total assets jumped \$144 million to \$1,576 million, representing a 10% increase over the prior fiscal year. The increase was primarily due to the addition of capital assets in accordance with the twenty-year capital plan for infrastructure and facilities.
- Total current liabilities increased by 14.8% or \$6.1 million to \$47.1 million primarily due to an increase in accounts payable. Total liabilities increased 32.9% or \$215 million to \$867.9 million while cash and cash equivalents also increased, due to the issuance of Wastewater Revenue Bonds in 2003.

### **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to Wastewater Enterprise's financial statements, which is comprised of the basic financial statements and notes to the financial statements.

**Basic financial statements.** The basic financial statements are designed to provide readers with a broad overview of the Wastewater Enterprise's finances, in a manner similar to a private-sector business.

The statement of net assets presents information of the Wastewater Enterprise's assets and liabilities, with the difference reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Wastewater Enterprise is improving or deteriorating. Net assets increase when revenues and subsidies exceed expenses. Increases to assets without a



corresponding increase to liabilities results in increased net assets, which indicate an improved financial position.

The statements of revenues, expenses, and changes in net assets present information showing how the Wastewater Enterprise's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

The statement of cash flows presents changes in cash and cash equivalents, resulting from operating, financing, and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

**Notes to financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

### **Financial Analysis**

Net assets (the difference between assets and liabilities) may serve, over time, as a useful indicator of a government's financial position. In the case of the Wastewater Enterprise, assets exceeded liabilities by \$708 million at the end of fiscal year 2003. This represented a decrease of \$71 million or 9% from the fiscal year 2002 net assets, which was mainly attributable to increases in transfers to the City's general fund.

The largest portion of the Wastewater Enterprise's net assets represented its invested in capital assets (e.g., land, buildings, transmission and distribution system, etc.). The Wastewater Enterprise uses these capital assets to provide wastewater services on the Island of Oahu and consequently, capital assets are not available to liquidate liabilities or other spending.

Additionally,

- Operating revenues, comprised mainly of sewer service charges, increased 1.7% to \$115.7 million for the fiscal year 2003. Sewer service charge rates have not been raised since 1994.
- Operating expenses dropped \$2.5 million or 2.6% to \$90.3 million for fiscal year 2003. The majority of the decrease was due to a reduction in administration and general costs.
- Contributed capital decreased from \$2.1 million in 2002 to \$1 million in 2003. Contributed capital represents assets (primarily capital assets) transferred from other city governmental funds and other entities.
- Of the \$59.6 million transfers, \$53.4 million pertain to reimbursement of expenditures made in prior years by the General Fund on behalf of the Sewer Fund.

The following are the highlights of the condensed financial information (in thousands of dollars) for the Wastewater Enterprise:

#### Net Assets

	2003	2002
Current and other assets	\$ 260,995	\$ 197,345
Capital assets, net	1,315,361	1,235,120
Total assets	1,576,356	1,432,465
Current liabilities	47,178	41,096
Noncurrent liabilities	820,806	611,989
Total liabilities	867,984	653,085
Invested in capital assets, net of related debt	625,114	650,381
Restricted for debt service	20,602	54,489
Unrestricted	62,656	74,510
Total net assets	\$ 708,372	\$ 779,380

#### Changes in Net Assets

	2003	2002
Operating revenues	\$ 115,747	\$ 113,810
Operating expenses	( 90,285)	( 92,738)
Income from operations	25,462	21,072
Nonoperating revenues (expenses):		
Interest income	2,032	4,779
Interest expense	( 35,354)	( 18,208)
Other	( 4,521)	( 1,753)
Income (loss) before transfers and contributed capital	( 12,381)	5,890
Transfers out	( 59,633)	( 46,995)
Contributed capital	1,006	2,066
Change in net assets	( 71,008)	( 39,039)
Net assets, beginning of year	779,380	818,419
Net assets, end of year	\$ 708,372	\$ 779,380

#### Capital Asset and Debt Administration

**Capital assets.** The Wastewater Enterprise's investment in capital assets amounted to \$1.3 billion, net of accumulated depreciation, as of June 30, 2003, an increase of \$80.2 million or 6.5%. Capital assets include land, buildings, infrastructure, land improvements, equipment and machinery for the eight treatment plants, sixty-eight pumping stations, and over 2,100 miles of sewer line that makes up the Wastewater Enterprise. Capital assets are added, rehabilitated or replaced according to the infrastructure and facilities twenty-year capital plan.

**Long-term debt.** Wastewater revenue bonds and State revolving fund loans are the primary long-term financing instruments used to fund the acquisition of capital assets. Junior Series Wastewater System Revenue Bonds of \$218.4 million were issued on May 8, 2003. Revenue bonds outstanding as of June 30, 2003 totaled \$678.2 million. State revolving fund notes payable outstanding at June 30, 2003 totaled \$85.5 million of which \$480,500 were secured during fiscal year 2003.

Debt service coverage was 511% on Senior Revenue Bonds, 242% on all revenue bonds, and 163% on all debt at June 30, 2003 and exceeded the requirements of bond covenants and policies of the City Council.

The revenue bonds issued on May 8, 2003 were rated AAA from Moody's Investor Services Inc. and AAA from Fitch Inc.

The Wastewater Enterprise has plans to issue approximately \$130 million in Wastewater Revenue Bonds during fiscal year 2004. The proceeds will be used to fund the acquisition and construction of capital assets.

Additional information on the Wastewater Enterprise's capital assets and long-term debt can be found in the notes to the financial statements.

### **Requests for Information**

This financial report is designed to provide a general overview of Wastewater Enterprise's finances for all those with an interest in its finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the City and County of Honolulu, Department of Environmental Services, 1000 Uluohia Street, Suite 308, Kapolei, HI 96707.

**City and County of Honolulu**  
**Sewer Fund**  
**Statements of Net Assets**  
**June 30, 2003 and 2002**

	2003	2002
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 115,546,447	\$ 25,072,545
Investments	98,631,665	142,946,421
Receivables –		
Accounts (net of allowance for uncollectible accounts of		
\$471,201 and \$308,226 in 2003 and 2002, respectively)	16,336,235	16,771,958
Interest	430,827	984,947
Due from other City funds	25,626,523	6,858,896
Inventories of materials and supplies	4,423,180	4,710,434
Total current assets	<u>260,994,877</u>	<u>197,345,201</u>
<b>Capital Assets, Net</b>	<u>1,315,361,303</u>	<u>1,235,120,372</u>
	<u>1,576,356,180</u>	<u>1,432,465,573</u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities:</b>		
Accounts payable	18,166,518	5,983,973
Bonds payable	10,871,282	10,905,590
Notes payable	5,618,869	5,408,026
Tax-exempt commercial paper	-	10,183,484
Interest payable	11,712,471	8,126,580
Other current liabilities	808,327	487,902
Total current liabilities	<u>47,177,467</u>	<u>41,095,555</u>
<b>Notes Payable</b>	79,876,758	85,002,960
<b>General Obligation Bonds Payable</b>	57,952,534	67,644,502
<b>Revenue Bonds Payable</b>	677,158,747	453,412,890
<b>Other Liabilities</b>	5,818,158	5,929,076
Total liabilities	<u>867,983,664</u>	<u>653,084,983</u>
<b>Commitments and Contingencies</b>		
<b>Net Assets:</b>		
Invested in capital assets, net of related debt	625,114,171	650,381,346
Restricted for debt service	20,602,552	54,489,107
Unrestricted	62,655,793	74,510,137
Total net assets	<u>\$ 708,372,516</u>	<u>\$ 779,380,590</u>

The accompanying notes are an integral part of the financial statements.

**City and County of Honolulu**  
**Sewer Fund**  
**Statements of Revenues, Expenses and Changes in Fund Net Assets**  
**For the Years Ended June 30, 2003 and 2002**

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	2003	2002
<b>Operating Revenues:</b>		
Sewer service charges	\$ 111,878,243	\$ 112,147,942
Other revenue	3,868,965	1,662,009
Total operating revenues	<u>115,747,208</u>	<u>113,809,951</u>
<b>Operating Expenses:</b>		
Depreciation	30,289,626	29,983,222
Administrative and general	29,502,109	32,942,854
Fringe benefits	8,711,036	10,676,502
Contractual services	7,571,344	6,665,001
Utilities	7,425,656	6,753,502
Materials and supplies	4,857,433	3,849,583
Fuel and lubricants	1,695,245	1,641,179
Maintenance	232,788	226,071
Total operating expenses	<u>90,285,237</u>	<u>92,737,914</u>
Operating income	25,461,971	21,072,037
<b>Nonoperating Revenues (Expenses):</b>		
Interest income	2,031,906	4,779,138
Interest expense	(35,353,648)	(18,208,184)
Other	(4,520,841)	(1,752,860)
Total nonoperating expenses	<u>(37,842,583)</u>	<u>(15,181,906)</u>
Income (loss) before transfers and contributed capital	(12,380,612)	5,890,131
<b>Transfers Out</b>	(59,633,026)	(46,995,060)
<b>Contributed Capital</b>	<u>1,005,564</u>	<u>2,066,157</u>
Change in net assets	(71,008,074)	(39,038,772)
<b>Net Assets at Beginning of Year</b>	<u>779,380,590</u>	<u>818,419,362</u>
<b>Net Assets at End of Year</b>	<u>\$ 708,372,516</u>	<u>\$ 779,380,590</u>

The accompanying notes are an integral part of the financial statements.

**City and County of Honolulu**  
**Sewer Fund**  
**Statements of Cash Flows**  
**For the Years Ended June 30, 2003 and 2002**

	2003	2002
<b>Cash Flows from Operating Activities:</b>		
Cash received from customers	\$ 115,754,729	\$ 113,200,021
Cash payments to suppliers and employees	(48,089,800)	(59,092,600)
Payments to other funds for internal activity	(18,767,628)	(1,660,703)
Other expenses	(435,823)	(75,437)
Net cash provided by operating activities	<u>48,461,478</u>	<u>52,371,281</u>
<b>Cash Flows from Noncapital Financing Activities:</b>		
Transfers out	(59,633,026)	(46,995,060)
Net cash used in noncapital financing activities	<u>(59,633,026)</u>	<u>(46,995,060)</u>
<b>Cash Flows from Capital and Related Financing Activities:</b>		
Acquisition and construction of capital assets	(105,146,995)	(68,742,158)
Proceeds from issuance of notes	480,454	26,022,039
Repayments on notes	(5,395,813)	(4,441,029)
Interest paid on notes	(2,988,701)	(2,572,969)
Proceeds from issuance of tax-exempt commercial paper, net	-	10,180,285
Proceeds from issuance of bonds, net of discount	195,082,807	134,067,084
Repayments on bonds	(1,051,525)	(10,863,040)
Interest paid on bonds	(26,235,561)	(21,562,595)
Net cash provided by capital and related financing activities	<u>54,744,666</u>	<u>62,087,617</u>
<b>Cash Flows from Investing Activities:</b>		
Purchase of investments	(262,028,884)	(465,309,193)
Proceeds from maturity of investments	306,343,640	387,639,100
Interest on investments	2,586,028	4,476,283
Net cash provided by (used in) investing activities	<u>46,900,784</u>	<u>(73,193,810)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	90,473,902	(5,729,972)
<b>Cash and Cash Equivalents, beginning of year</b>	<u>25,072,545</u>	<u>30,802,517</u>
<b>Cash and Cash Equivalents, end of year</b>	<u>\$ 115,546,447</u>	<u>\$ 25,072,545</u>

The accompanying notes are an integral part of the financial statements.

**City and County of Honolulu**  
**Sewer Fund**  
**Statements of Cash Flows (continued)**  
**For the Years Ended June 30, 2003 and 2002**

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	2003	2002
<b>Cash Flows from Operating Activities:</b>		
Operating income	\$ 25,461,971	\$ 21,072,037
Adjustments to reconcile operating income to net cash provided by operating activities –		
Depreciation expense	30,289,626	29,983,222
Other revenues and expenses	-	(129,874)
Write-off of capital assets	430,889	4,792,424
Increase (decrease) in accounts receivable	435,723	(366,396)
Increase in due from other City funds	(18,825,946)	(1,549,893)
Increase (decrease) in materials and supplies inventory	287,254	(429,309)
Increase (decrease) in accounts payables	10,114,137	(1,349,917)
Increase in other liabilities	267,824	348,987
	<u>48,461,478</u>	<u>52,371,281</u>
Net cash provided by operating activities	\$ <u>48,461,478</u>	\$ <u>52,371,281</u>

**Supplemental Disclosure of Noncash Capital and Related Financing Activities:**

The Sewer Fund received \$1,005,564 and \$2,066,157 in contributions of capital assets from government agencies and developers, which are recorded as contributed capital at their cost or estimated cost at June 30, 2003 and 2002, respectively.

The accompanying notes are an integral part of the financial statements.

**City and County of Honolulu**  
**Sewer Fund**  
**Notes to Financial Statements**  
**June 30, 2003 and 2002**

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**1. Financial Reporting Entity**

The Sewer Fund ("Fund") was established in 1976 pursuant to Section 14-8.1 of the 1990 Revised Ordinances of the City and County of Honolulu to account for all monies received pursuant to the provisions of the Federal Water Pollution Control Act amendments of 1972 and the Hawaii Revised Statutes and expended for the purposes authorized (operations of the City's wastewater system). The fund was operated primarily through user charges. The City and County of Honolulu (the "City") also established the Sewer Revenue Bond Improvement Fund to account for the proceeds of bonds issued to pay all or part of those appropriations for improvements, repairs, and maintenance of the wastewater treatment system.

In conjunction with the November 1998 City Resolution 98-193, CD1, authorizing the issuance of the Wastewater System Revenue Bonds for the Wastewater System, a new Sewer Fund was established effective July 1, 1999 as an enterprise fund. The new Sewer Fund combines the operations of the Sewer and Sewer Revenue Bond Improvement Funds, which were previously recorded in a special revenue fund and certain capital projects funds. Accordingly, various account balances, including cash and fixed assets, net of related debt, were transferred into the new Sewer Fund (the "Fund").

**2. Summary of Significant Accounting Policies**

**Financial Statement Presentation**

These financial statements follow Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. Under GASB No. 20, all applicable GASB pronouncements as well as all applicable Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board Opinions issued on or before November 30, 1989 are applied, unless those pronouncements conflict or contradict GASB pronouncements.

The Fund follows GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and No. 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These Statements provide for new financial reporting requirements for state and local governments.

**Basis of Accounting**

The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

The City distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Fund's principal wastewater operations. The principal operating revenues are from charges for wastewater system usage, while operating expenses include cost of services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.



**City and County of Honolulu**  
**Sewer Fund**  
**Notes to Financial Statements**  
**June 30, 2003 and 2002**

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**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

Cash includes amounts in demand and time deposits primarily with various financial institutions in Hawaii. Cash on deposit with financial institutions is collateralized in accordance with State statutes. Investments with original maturity of three months or less when purchased are considered cash equivalents.

**Investments**

Investments consist of U.S. government securities and are stated at cost, which approximates fair value.

**Capital Assets**

Capital assets include property, plant and equipment, including infrastructure (sewer system, network of pipes and sewer mains) and are capitalized at cost. Interest cost is capitalized as part of the cost of acquiring certain assets. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<b>Years</b>
Buildings and improvements other than buildings	10-50
Transmission and distribution system	60
Equipment and machinery	3-20

Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains or losses on sales and retirements of property are reflected in results of operations.

Normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Betterments are capitalized and depreciated over the remaining useful lives of the related assets, as applicable.

Effective July 1, 2001, the City raised its equipment capitalization threshold to \$5,000 and its buildings, improvements and infrastructure threshold to \$100,000. Management believes the new capitalization threshold is more consistent with the industry standard and will lessen the administrative burden on its staff.

The change in the capitalization threshold resulted in a write-off of assets of approximately \$4.5 million.

**City and County of Honolulu**  
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**Inventories of Materials and Supplies**

Inventories of materials and supplies are stated at weighted average cost. The costs of inventories are recorded as expenditures when consumed rather than when purchased.

**Receivables**

Sewer service charge revenues are accrued by the City based on estimated billings for services provided through the end of the fiscal year. Estimated unbilled sewer charges amounted to approximately \$8.6 million and \$10.7 million at June 30, 2003 and 2002, respectively.

**Contributed Capital**

Contributed capital represents assets transferred from or constructed utilizing contributions from governmental agencies and developers and recorded at cost on the date placed in service.

**Net Assets**

Net assets comprise the various net earnings (losses) from operating and nonoperating revenues, expenses, operating transfers and contributed capital. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted net assets. Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and is reduced by outstanding debt that is attributable to the acquisition, construction or improvement of those assets. Debt related to unspent proceeds or other restricted cash and investments at year-end are not included in the calculation of the amount invested in capital assets, net of related debt. Restricted for capital activity and debt service consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consist of all other net assets not included in the above categories.

**Retirement Plan Contributions**

The City's contribution to the Employee's Retirement System of the State of Hawaii (see Note 8) is based upon actuarial computations and is comprised of the normal cost plus a level annual payment required to amortize an unfunded actuarial accrued liability over the remaining period of 27 years from July 1, 2002. The City is required by State statute to fund the actuarially determined pension contribution requirement annually.

**Deferred Compensation Plan**

All full-time employees of the Fund are eligible to participate in the City and County of Honolulu's Public Employees' Deferred Compensation Program ("Plan"), adopted pursuant to Internal Revenue Code Section 457. The plan permits eligible employees to defer a portion of their salary until future years by contributing to a fund managed by a plan administrator. The deferred compensation amounts are not available to employees until termination, retirement, death or unforeseeable emergency.

A trust fund (annuity contract) was established to protect plan assets from claims of general creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. Deferred compensation plan assets are not reported in the financial statements.

**City and County of Honolulu**  
**Sewer Fund**  
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**June 30, 2003 and 2002**

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**Compensated Absences**

Vacation benefits accrue at one and three-quarters working days for each month. Each employee is allowed to accumulate a maximum of 90 days of vacation as of the end of the calendar year. At June 30, 2003 and 2002, accrued vacation amounted to approximately \$5.8 million and \$5.7 million, respectively.

Sick leave accumulates at the rate of one and three-quarters working days for each month, without limit. Sick leave is taken only in the event of illness and is not convertible to pay; accordingly, sick leave is not accrued. Employees who retire or leave government service in good standing with sixty or more unused sick leave days are entitled to an additional service credit in the retirement system. At June 30, 2003 and 2002, accumulated sick leave, including vested and nonvested accumulated rights to receive sick leave benefits, amounted to \$16.8 million and \$17.1 million, respectively.

**Transfers**

Transfers include authorized transfers of resources from the fund legally required to receive them to the Fund through which such resources are to be expended.

**Reclassifications**

Certain balances in the 2002 financial statement have been reclassified to conform to the 2003 presentation. These reclassifications had no effect on the change in net assets as previously reported.

**3. Cash and Investments**

The cash and investments balances reported in the accompanying balance sheets are included in the City's cash and investment pool that is used by substantially all of the City's funds. Information pertaining to bank and investment balances and classification of risk is available for only the total cash and investment pool. These balances were fully insured or collateralized with securities by the City's agent in the City's name.

**4. Due From Other City Funds**

Due from other City funds consists primarily of temporary fund transfers to the City's Federal Grants Fund of \$20 million and bond proceeds relating to bond issuances for the Fund held by the City's General Improvement Bond Fund of \$5.4 million at June 30, 2003. Due from other City funds consisted primarily of bond proceeds relating to bond issuances for the Fund held by the City's General Improvement Bond Fund of \$6.6 million at June 30, 2002.

**City and County of Honolulu**  
**Sewer Fund**  
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**June 30, 2003 and 2002**

**5. Capital Assets**

The capital assets activity for the years ended June 30, 2003 and 2002 were as follows:

	Balance at July 1, 2002	Additions	Retirements/ Transfers	Balance at June 30, 2003
<b>Depreciable Assets:</b>				
Buildings and improvements	\$ 394,423,418	\$ 42,229,342	\$ -	\$ 436,652,760
Transmission and distribution system	787,519,031	5,749,128	-	793,268,159
Equipment and machinery	19,962,871	1,911,505	(87,600)	21,786,776
Land improvements	2,551,670	1,122,991	-	3,674,661
Total depreciable assets	1,204,456,990	51,012,966	(87,600)	1,255,382,356
<b>Less Accumulated Depreciation:</b>				
Buildings and improvements	(26,985,826)	(9,893,215)	-	(36,879,041)
Transmission and distribution system	(50,548,742)	(18,036,052)	-	(68,584,794)
Equipment and machinery	(6,904,608)	(2,123,395)	87,600	(8,940,403)
Land improvements	(217,182)	(236,961)	-	(454,143)
Total accumulated depreciation	(84,656,358)	(30,289,623)	87,600	(114,858,381)
	1,119,800,632	20,723,343	-	1,140,523,975
<b>Land</b>	5,629,502	211,338	-	5,840,840
<b>Construction Work in Progress</b>	109,690,238	109,727,686	(50,421,436)	168,996,488
	<u>\$ 1,235,120,372</u>	<u>\$ 130,662,367</u>	<u>\$ (50,421,436)</u>	<u>\$ 1,315,361,303</u>
	Balance at July 1, 2001	Additions	Retirements/ Transfers	Balance at June 30, 2002
<b>Depreciable Assets:</b>				
Buildings and improvements	\$ 394,973,195	\$ 338,763	\$ (888,540)	\$ 394,423,418
Transmission and distribution system	754,020,617	33,498,414	-	787,519,031
Equipment and machinery	22,418,010	2,039,717	(4,494,856)	19,962,871
Land improvements	2,387,431	164,239	-	2,551,670
Total depreciable assets	1,173,799,253	36,041,133	(5,383,396)	1,204,456,990
<b>Less Accumulated Depreciation:</b>				
Buildings and improvements	(17,674,529)	(9,415,496)	104,199	(26,985,826)
Transmission and distribution system	(33,040,858)	(17,507,884)	-	(50,548,742)
Equipment and machinery	(5,877,439)	(2,975,816)	1,948,647	(6,904,608)
Land improvements	(133,977)	(83,205)	-	(217,182)
Total accumulated depreciation	(56,726,803)	(29,982,401)	2,052,846	(84,656,358)
	1,117,072,450	6,058,732	(3,330,550)	1,119,800,632
<b>Land</b>	5,367,575	273,387	(11,460)	5,629,502
<b>Construction Work in Progress</b>	70,490,437	72,243,177	(33,043,376)	109,690,238
	<u>\$ 1,192,930,462</u>	<u>\$ 78,575,296</u>	<u>\$ (36,385,386)</u>	<u>\$ 1,235,120,372</u>

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**6. Long-Term Debt**

The City issues general obligation bonds for the construction of major capital facilities. The Fund's general obligation bonds are collateralized by or expected to be paid from sewer user charges. These instruments are a direct obligation of the City for which its full faith and credit is pledged. The general obligation bonds for the Fund were issued during 1992 through 1998 in the original amount totaling \$373.7 million, and maturing serially through fiscal year 2018. The general obligation bonds bear interest at rates ranging from 5.0% to 5.86% at June 30, 2003.

Wastewater system revenue bonds were issued during 1999 through 2003 in the original amount totaling \$706.1 million, less a discount (\$25.8 million at June 30, 2003, which is being amortized over the related term of the bond). The bonds are subject to redemption, at the option of the City, prior to maturity, on or after July 1, 2011. The bonds bear interest at 0.9% to 5.0% at June 30, 2003 and mature at various dates through fiscal year 2033. The revenue bonds are collateralized by the Fund's revenues.

The notes payable to the Hawaii state government are for the construction of necessary treatment works and for other projects intended for wastewater reclamation or waste management. The notes amounted to \$85.5 million and \$90.4 million at June 30, 2003 and 2002, respectively, bearing interest ranging from 2.06% to 3.02%, and require annual principal and interest payments through fiscal year 2023.

During fiscal 2002, the City issued tax-exempt commercial paper of approximately \$10 million to refinance long-term debt. The tax-exempt commercial paper was repaid during fiscal 2003 with proceeds from the issuance of the wastewater system revenue bonds.

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Long-term debt activity for the years ended June 30, 2003 and 2002 were as follows:

	Balance at July 1, 2002	Additions	Reductions	Balance at June 30, 2003	Amount Due Within One Year
General obligation bonds	\$ 77,500,092	\$ -	\$ (9,771,276)	\$ 67,728,816	\$ 9,776,282
Revenue bonds	486,670,000	218,400,000	(1,050,000)	704,020,000	1,095,000
Notes payable	90,410,986	480,454	(5,395,813)	85,495,627	5,618,869
Tax-exempt commercial paper	10,183,484	-	(10,183,484)	-	-
	664,764,562	218,880,454	(26,400,573)	857,244,443	16,490,151
Less unamortized discount	(32,207,110)	-	6,440,857	(25,766,253)	-
Total long-term debt	<u>\$ 632,557,452</u>	<u>\$ 218,880,454</u>	<u>\$ (19,959,716)</u>	<u>\$ 831,478,190</u>	<u>\$ 16,490,151</u>

	Balance at July 1, 2001	Additions	Reductions	Balance at June 30, 2002	Amount Due Within One Year
General obligation bonds	\$ 87,353,132	\$ -	\$ (9,853,040)	\$ 77,500,092	\$ 9,855,590
Revenue bonds	351,660,000	136,020,000	(1,010,000)	486,670,000	1,050,000
Notes payable	68,829,976	26,022,039	(4,441,029)	90,410,986	5,408,026
Tax-exempt commercial paper	3,199	10,183,484	(3,199)	10,183,484	10,183,484
	507,846,307	172,225,523	(15,307,268)	664,764,562	26,497,100
Less unamortized discount	(32,207,110)	-	-	(32,207,110)	-
Total long-term debt	<u>\$ 475,639,197</u>	<u>\$ 172,225,523</u>	<u>\$ (15,307,268)</u>	<u>\$ 632,557,452</u>	<u>\$ 26,497,100</u>

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Scheduled maturities of long-term debt is as follows:

	General Obligation Bonds	Revenue Bonds, Net	Notes Payable	Total
Year ending June 30,				
2004	\$ 9,776,282	\$ 1,095,000	\$ 5,618,869	\$ 16,490,151
2005	9,692,027	1,140,000	5,756,157	16,588,184
2006	9,612,770	3,550,000	5,893,656	19,056,426
2007	9,145,584	3,710,000	6,035,511	18,891,095
2008	8,084,586	8,775,000	6,179,872	23,039,458
2009-2013	21,378,615	82,665,447	33,211,064	137,255,126
2014-2018	38,952	110,997,605	19,338,023	130,374,580
2019-2023	-	148,455,695	3,462,475	151,918,170
2024-2028	-	196,920,000	-	196,920,000
2029-2033	-	120,945,000	-	120,945,000
	67,728,816	678,253,747	85,495,627	831,478,190
Less current portion	9,776,282	1,095,000	5,618,869	16,490,151
	<u>\$ 57,952,534</u>	<u>\$ 677,158,747</u>	<u>\$ 79,876,758</u>	<u>\$ 814,988,039</u>

**7. Net Assets**

At June 30, 2003 and 2002, net assets consisted of the following:

	2003	2002
<b>Invested in Capital Assets, Net of Related Debt:</b>		
Net property, plant and equipment	\$ 1,315,361,303	\$ 1,235,120,372
Less:		
Wastewater general obligation bonds payable	(67,728,816)	(77,500,092)
Wastewater system revenue bonds payable, net	(678,253,747)	(454,462,890)
Notes payable	(85,495,627)	(90,410,986)
Tax-exempt commercial paper	-	(10,183,484)
Amount of debt related to unspent debt proceeds	141,231,058	47,818,426
	625,114,171	650,381,346
<b>Restricted for Debt Service</b>	20,602,552	54,489,107
<b>Unrestricted</b>	62,655,793	74,510,137
	<u>\$ 708,372,516</u>	<u>\$ 779,380,590</u>
Total net assets		

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**8. Employee Benefit Plans**

**Defined Benefit Pension Plans**

*Plan Description*

Substantially all eligible employees of the City are members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing multiple-employer defined benefit pension plan. The ERS provides retirement benefits as well as death and disability benefits and is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to create a new noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003 is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment or, highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment.

Most covered employees of the contributing option are required to contribute 7.8% or 12.2% of their salary. The City is required to contribute the remaining amounts necessary to pay contributory plan benefits and all amounts necessary to pay noncontributory benefits when due. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the remaining period of 29 years from July 1, 2000. The Fund's contribution to the ERS was \$2.9 million in 2003 and 2002, which was equal to the required contributions for the respective years.

The ERS issues a Comprehensive Annual Financial Report that may be obtained by writing to the Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

**Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State of Hawaii provides certain health care and life insurance benefits for retired City employees. Contributions are based on negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage. Prior to July 1, 1996, the City paid for 100% of these benefits for employees who have at least 10 years of



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service. According to Act 217, SLH 1995, employees hired after June 30, 1996 with 25 years or more of service receive 100% employer funding. The City's share of the cost of these benefits is prorated for employees with less than 25 years of service. The City also reimburses 100% of Medicare expenses for retirees and qualified dependents (through the State) who are at least 65 years of age and have at least 10 years of service. Currently, approximately 9,246 retirees and qualified dependents are receiving post retirement health care and benefits paid for by the City. The City's contributions for post retirement benefits, which are funded as accrued, amounted to \$34.2 million and \$32.1 million for the fiscal years ended June 30, 2003 and 2002, respectively. Separate information for the Fund is not available.

**Early Retirement Incentive**

Act 212 of the 1994 regular session of the State legislature authorized an early retirement incentive to state and county employees with at least 25 years of service as of December 31, 1994. Qualifying employees received two additional years of service credits for purposes of calculating their retirement benefits. 571 City employees received early retirement benefits, which cost the City \$7.5 million in payouts for accrued vacation during fiscal 1995. Act 147 of the 2002 State Legislative Session lowered the employer contributions to ERS by extending the payment schedule for the actuarial present value cost of the early retirement incentive bonus to 19 years effective for the year ended 2000. The City's annual payments amount to \$790,365 per year. Based on the per-employee analysis of additional retirement contributions calculated by the ERS, the additional retirement contribution, including interest, to be paid by the City for the early retirees is \$20.3 million. At June 30, 2003 and 2002, the remaining balance was \$9.2 million and \$9.3 million, respectively. Separate information for the Fund is not available.

**9. Management Agreement**

The City and County of Honolulu has an agreement with the Board of Water Supply (the "Board") to provide certain services through June 30, 2004 relating to the billing and collection of sewer service charges. Fees related to these services were negotiated at approximately \$100,000 per year through fiscal 2003. The fees for 2004 are subject to negotiation.

**10. Commitments and Contingencies**

The City has contractual commitments for the Fund of approximately \$204.5 million at June 30, 2003, primarily for construction contracts.

**Credit Risk**

Financial instruments, which potentially expose the City to concentrations of credit risk, consist primarily of cash, investments in debt securities, and accounts receivable from customers. Cash and cash equivalents are maintained in various financial institutions in Hawaii. Credit risk related to investments in debt securities has been mitigated by limiting such investments to debt obligations of the U.S. government. The customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the City is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2003, except

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as provided in the allowance for uncollectible accounts. The City manages its credit exposure through procedures designed to identify and monitor credit risk.

**Litigation**

The City is a party to various legal proceedings arising in the normal course of business. Some of these matters relate to the Fund as follows:

**Clean Water Act**

In 1991, the EPA filed an administrative action against the City alleging violations of the Clean Water Act and conditions and limitations of the National Pollutant Discharge Elimination System ("NPDES") Permits by failing to develop and administer pretreatment programs for all of its treatment plants and for unauthorized discharges from the collection system. As a result of a settlement reached between the EPA and the City, a consent decree has been filed which requires certain compliance actions and penalties of \$1.2 million, which were paid in fiscal year 1995. The City has implemented certain compliance actions such as developing rehabilitation and maintenance of the collection system and implementation of the plans. The City has committed to spend at least \$20 million for effluent reuse. The City is currently recycling approximately 7.2 million gallons per day from the Honouliuli Reclamation Facility, which was recently purchased by the Board of Water Supply.

The City has also committed to spend at least \$10 million for sludge reuse. Sludge reuse is being accomplished through the U.S. Navy Biosolids Treatment Facility. The cost to the City is \$82 per wet ton of sludge delivered to the facility. Currently, the City is delivering an average of 10.3 dry tons per day. The consent decree cites potential stipulated penalties of \$2,000 per day per violation for failure to comply.

The State and certain environmental groups (nonprofit organizations) also filed actions against the City for declaratory judgment, injunctive relief and civil penalties for violations of the Clean Water Act for the following wastewater treatment plants:

*Kailua and Kaneohe*

As a result of a settlement reached between the parties, a consent decree has been filed for the Kailua and Kaneohe plants, which requires certain compliance actions such as developing a facilities plan, constructing a feasible ultraviolet disinfection facility and establishing and supporting an advisory council. The conceptual facilities plan and the environmental impact statement preparation notice were completed in September 1998. The design phase of the ultraviolet disinfection project was completed in October 1998. Responses to public comments were completed in June 1999. The City contracted a construction company to complete the construction phase for approximately \$2.3 million, which was completed in November 2000. Approximately \$5.3 million has been paid as of June 30, 2003, related to these compliance actions. The Kailua Bay Advisory Council was established in October 1995. The City established a \$2.1 million trust fund; hired a program administrator and a third party to provide watershed mapping services; awarded grant projects to four community groups; developed short-term implementation plans for erosion control initiatives, stream bank restoration and refuse control; and developed a web site for the Kailua Bay Advisory Council to disseminate information to the public.

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The consent decree cites total costs of at least \$7.4 million for capital improvements, consulting and other fees. The consent decree cites stipulated penalties of \$500 per day per violation for failure to meet the specified obligations and deadlines. The Kaneohe treatment facility has been converted into a temporary pre-treatment facility, and pumps wastewater to the Kailua treatment facility.

*Wahiawa*

A civil action was filed by the State for operating the Wahiawa plant without a permit. Settlement with the State was reached and a consent decree was approved on February 27, 1998. The consent decree requires the City to upgrade the existing treatment plant to produce water suitable for reuse and adjust the outfall. The consent decree cites stipulates damages of \$600,000 plus \$1,000 – \$5,000 per day if the upgrades are not completed by specified deadlines. In June 2001, the City completed construction of the reclamation system, which amounted to approximately \$12 million. As required by the consent decree, the City also disbursed \$150,000 to various agencies for supplemental environmental projects. A motion to terminate the consent decree has not been filed by the State or City.

*Sand Island*

The Sand Island wastewater treatment plant operates under a 301(h) waiver permit issued by the EPA. The current permit was effective November 1998. That permit included, amongst other things, a specific timetable for various construction projects related to the Sand Island plant. In October 1999, the EPA issued a finding of violation and order for compliance that required corrective measures and compliance with the November 1998 permit. Although the City responded to that order, some of the construction projects are behind the permit schedule due to unanticipated construction difficulties. For example, an Ultraviolet Disinfection facility was to be constructed by July 1, 2002. That facility is still under construction and is not currently estimated to be completed until October 1, 2004. In October 2002, the EPA identified that the Sand Island plant violated certain discharge limits and ordered the City to stop discharge violations at the Sand Island plant and to submit a plan by December 1, 2002, to bring the facility into continuous compliance with its EPA permit. The City submitted the required plan and compliance schedule on November 29, 2002. Upon review by the EPA, the City submitted a revised plan on May 1, 2003, which is still subject to the EPA's final approval. Failure to comply with the EPA orders could result in fines up to \$27,500 per day and a revocation or non-renewal of the 301(h) waiver permit. Revocation or non-renewal of the 301(h) waiver permit would require the City to upgrade the Sand Island plant to a secondary facility at a construction cost of hundreds of million of dollars.

*Kahuku*

The State issued a notice of apparent violation resulting from discharge of chlorinated secondary filtered effluent from an effluent pipe break at the Kahuku Wastewater Treatment Plant onto private property. The City has not been assessed any penalties, however, \$750,000 in costs were incurred to construct a new line.

Although the outcome of individual matters is not predictable, no provision for any liability that may result from these lawsuits has been made in the Fund's financial statements since any such liabilities are normally paid from the City's General Fund. In the opinion of management, the final outcome of these matters is unknown at this time but should not have a material adverse effect on the Fund's financial statements.